

MAY 2020

Investment Strategy



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Highlights Editorial Changes this month Summary of our main recommendations



The coronavirus epidemic

The global economic recession linked to the Covid-19 pandemic is worse than expected and we are revising down our growth estimates for 2020. The recovery in 2021 will be strong, thanks to the stimulus policies put in place. Inflation will remain lacklustre.

Positive on eurozone periphery bonds.

The financing of the European stimulus programmes will give rise to a compromise in which the existing institutions/mechanisms will be widely used. We are positive on eurozone periphery bonds.

We stick to our strategy of accumulating on weakness in the stock markets.

The short term remains uncertain (extent and duration of the recession/lockdown, downward earnings revisions, high volatility) but in the medium term, the recovery will be on track and profits will start to grow again. We are positive on the United States, the emerging market countries and the eurozone.

. We turn positive on China and Taiwan by focusing on their domestic markets.

. We increase our gold target to \$1600-1800.

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Coronavirus: latest update

In March, financial markets were hit by the worst health crisis of the past century: the lockdown of almost half the world's population plunged the global economy into a deep recession, and global stock markets plummeted by 34% in 30 days, the fastest bear market in history. In April, stock markets rebounded by 20% in Europe and by 25% in the US. The peak of the epidemic appears to have been reached in Europe, the reaction in terms of stimulative economic policies has been massive and rapid, and financial markets have begun to price in the rebound in economic growth. The start of May was difficult with the first two trading sessions recording sharp declines. So what will happen next? The short term is still very cloudy, and we would not be surprised if the consolidation movement seen in early May continues. More importantly, the long-term trend should be positive as we expect a gradual pick-up in activity in the second half of the year, and amplifying next year.

Our forecasts for the global economy

All economic forecasts (our own as well as those of international bodies or other companies) have been systematically revised down since the onset of the pandemic. Confinement measures are much wider and on a much larger scale than expected, and lockdown exit plans are not yet defined. For example we do not know how long governments will continue to keep whole segments of the economy at a standstill. Neither do we know how long it will take to return to a 'normal' pace of economic activity. China, the first country to exit the pandemic and lift confinement measures, is resuming its activity, but the return to normality is an uncertain challenge.

All states and central banks have put in place unprecedented measures on a large scale: tax deferrals, loan guarantees, aid for temporary layoffs/furloughs, massive liquidity injections etc. The idea is to limit business closures to keep the production tool intact, and it will get going again as soon as lockdown measures are lifted/relaxed. Hence a U-shaped growth profile with a recovery in the second half that will be amplified next year. See the table for more details by country.

The risks to this forecast are mainly to the downside, in which case, we would talk of a W-shaped profile. What are the unknowns? The length of lockdown, the timing between political decisions and their tangible implementation, the impact of 'deglobalisation' that is looming in several sectors deemed strategic, the likely rise in savings rates, all of which are unknown and which favour darker scenarios. Conversely, a vaccine or a new drug to treat Covid-19 would reduce uncertainties.



- We are often asked the following question: "Isn't inflation likely to pick up as a result of these stimulus policies and massive liquidity injections?". In our view, however, it is still too early to conclude that the risks of deflation are totally ruled out. Structural factors that limit the acceleration of inflation are still very powerful (price-cutting pressure with digital and e-commerce, low productivity growth, the ageing population). Certainly, less globalisation could increase prices in some segments. However, on the other hand, recession, rising unemployment and savings rates as well as the collapse in oil prices will push prices down over the coming quarters. There is still the monetarist argument of the creation of huge amounts of liquidity by central banks: Isn't there a risk of mechanical inflation? In fact, as long as the money multiplier remains as low as it is presently (incidentally the level since the great financial crisis), central bank interventions do not boost inflation, but rather limit the risk of deflation.
- In our forecasts, inflation will remain between 0 and +1% in 2020 and may accelerate towards +2% in 2021 if (as we believe) oil prices rebound towards \$45-55 by year-end. Black gold will be supported by the combination of a recovery in demand for oil linked to the rebound in global growth at a time when crude production will be reduced (voluntarily by the enlarged OPEC, under duress of operating losses in the United States). We will ask ourselves later (in 2021?) the question of a possible acceleration in inflation if the global economy responds better than expected to the various stimulus measures.

Opportunities arising from the European crisis

Eurozone periphery bond spreads have widened over the past couple of months, particularly in Italy. The ECB's intervention has reduced the pressure on this country, especially as S&P has decided against lowering Italy's rating. There are important questions about the financing of all these stimulus programmes announced in the eurozone, particularly for countries that already have high levels of debt. The debate between Europeans on how to do this is undecided. We believe that this debate will bring a positive end for the eurozone, a solution that will result in a narrowing of peripheral spreads. Existing tools, for which an agreement has already been reached, will be used fully. The European Stability Mechanism, European Investment Bank and European Insurance Fund are expected to be operational as of 1 June. In addition, the European Commission must (within 2 weeks) develop a proposal for a new recovery fund, financed from the Commission's budget. So we are not talking about eurobonds.

The similar reasoning about good quality Corporate bonds prompts us to be positive on Investment Grade in both Europe and the US, mainly thanks to the support of central banks. The ECB and Fed announced that IG would be part of their QE, i.e. their bond-buying programmes on the market.

We stick to an accumulation strategy on stock markets

Volatility levels on stock market indices remain high: the VIX and V2X were close to 40% at the time of writing. Short-term uncertainty dominates; a) the pandemic is far from over, particularly in the United States; b) the magnitude of the recession is constantly being revised upwards, with disastrous economic data publications in March and April. The month of May is unlikely to be better; c) companies are currently publishing their first quarter results and logically analysts are sharply revising down their forecasts for the full year. But a host of companies are no longer providing 'guidance' (anticipation of their future results) because visibility is low.

We prefer to focus on a slightly longer horizon: in the second half of the year, macroeconomic data will improve as lockdown measures will be lifted gradually, and government stimulus measures will be implemented. This positive momentum will continue in 2021 and corporate profits will return to the growth path, while interest rates will remain low.

Our preferred markets are still the United States, the emerging countries (Asia in particular) and the eurozone, in that order. We recommend taking advantage of periods of hesitation to accumulate and strengthen positions. This month, we are adding China and Taiwan to our list of preferred markets. No change to our sector views: we are positive overall on health care and insurance. And positive too, in Europe, on energy, technology and building materials.



Changes this month

- We are positive on the Chinese and Taiwanese equity markets and focus on the rebound in domestic demand in these two countries. The worst of the health crisis is behind us in these two economies where governments are pursuing reflation policies in a bid to boost local consumption. Manufacturing and exports are suffering in both countries because of the recession in the global economy. Valuations on these two stock markets are attractive, while profit forecasts have already been sharply revised down.
- We raise our targets on the ounce of gold to \$1600-1800 (from \$1535-2735). Gold remains uncorrelated to other financial assets and plays a role of hedging against risk. Central banks are very accommodative, and are keeping real rates very low, which is a positive factor for gold.





Equities

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|---------|---|---|
| Global | ● | <ul style="list-style-type: none"> • A strategy of accumulation. Half of the bear market has been erased thanks to better news on the coronavirus front and unprecedented monetary and fiscal mobilisation. The absence of positive macro and earnings releases in the coming months, coupled with technical considerations imply rising volatility. Investors should take advantage of it to accumulate. |
| Markets | ● | <ul style="list-style-type: none"> • US stocks remain a firm favourite, well positioned to continue its 11-year old outperformance. • Euro Area stocks: better days lie ahead with an expected global recovery in the second half. • Recovery potential for the UK market, provided by extreme discount valuations. • Emerging Markets have been cheaper only 3% of the time according to the Shiller PE. We add China and Taiwan to our favourite markets. They also include South Korea, India and Singapore. |
| Sectors | ● | <ul style="list-style-type: none"> • Positive on Healthcare and Insurance. • Recently, we had downgraded US Energy to neutral but stayed positive on EU Energy. • In Europe: positive on Technology and Construction Materials. |

Bonds

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|-------------------|--------|--|
| Govies | ●
● | <ul style="list-style-type: none"> • We are negative on German govies, whatever the maturity, and on long-term US govies. • We are positive on the front-end of the US yield curve for USD-based investors as short-term yields have limited upside. • We are positive from neutral on periphery debt (Portugal, Italy, Spain, Greece) on a buy on weakness strategy. |
| Investment Grades | ● | <ul style="list-style-type: none"> • We prefer corporate bonds over government bonds. • We like EUR and US IG bonds with a duration at benchmark (5 and 8 years, respectively). • We are positive on eurozone convertible bonds. |
| High Yield | ● | <ul style="list-style-type: none"> • We are neutral on both US and eurozone HY. |
| Emerging | ●
● | <ul style="list-style-type: none"> • We are positive on EM local currency bonds, for both USD and EUR based investors, and neutral on EM hard currency bonds (sovereigns and corporates). |

Forex

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| EM | ● | <ul style="list-style-type: none"> • We keep a positive view on EM currencies. We however see a smaller appreciation than before except for the yuan. |
| USDZAR | ● | <ul style="list-style-type: none"> • We expect the ZAR to reach 17.5 (value of 1 USD) short-term before strengthening around 16.5 over the next 12 months. |
| USDMXN | ● | <ul style="list-style-type: none"> • We see the MXN appreciating to 22 (value of 1 USD) over the next 3 months and then reaching our revised 12-month target around 20. |

Commos

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| Oil | ● | <ul style="list-style-type: none"> • Brent prices should recover around \$45-55 at the end of 2020 thanks to the rebounding demand and lower supply. |
| Gold | ● | <ul style="list-style-type: none"> • We increase our trading range to \$1600-1800 as the new monetary stimuli decided by the central banks can only put more pressure on real bond yields for longer |
| Base Metals | ● | <ul style="list-style-type: none"> • Downside risks should remain elevated as long as the sanitary lockdowns are not lifted globally. China being the leading buyer, the timing of the expected rebound will depend from the pace of its recovery itself depending on the normalization of the rest of the world. |

Alternatives

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|-------------|---|---|
| Real Estate | ● | <ul style="list-style-type: none"> • Positive for a 'value-added' commercial investment strategy, executed by first-class asset managers. Neutral on REITs with 'long-only' strategies, irrespective of geography. |
| Alt. UCITS | ● | <ul style="list-style-type: none"> • Positive on Event-Driven, Macro and Long-Short equity. Cautious on relative-value strategies. |





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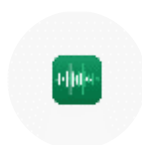
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Voice of Wealth

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